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Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Prohibition on Proprietary Trading and Certain Relationships With Hedge Funds and Private Equity Funds (RIN 7100-AD-82; Docket No. OCC-2011-0014; RIN 3065-AD85; S7-41-11; RIN 3038-AD05)

Dear Ladies and Gentlemen:

Regarding your ongoing consideration of the Volcker Rule, Better Markets would like to call your attention to the attached article, "Secret Goldman Team Sidesteps Volcker After Blankfein Vow," from Bloomberg News.¹ The article describes strategies, reportedly already in place at Goldman Sachs, to evade or game the Volcker Rule prohibitions on proprietary trading and hedge fund operation as they are set forth in the currently proposed rule. For example, as described in the article, these strategies include taking trading positions purportedly for periods longer than 60 days, which would allow a bank to claim their trades are technically not a violation of the Volcker Rule because the proposed rule has a presumption that prohibited trading takes place within 60 days.

These activities are reported to already be very substantial, even just a few years after the financial crisis. For example, Goldman's "proprietary stock holdings were so large that markdowns on stakes in Asia helped wipe out revenue from client work there in 2011, according to data compiled by Bloomberg." Goldman's CEO, Lloyd Blankfein, appears to confirm such significant proprietary trading when he was asked does "Goldman Sachs make

¹ <http://www.bloomberg.com/news/2013-01-08/secret-goldman-team-sidesteps-volcker-after-blankfein-vow.html>

the bulk of its profit from proprietary [trading] instead of client work?" Blankfein didn't say "no." He merely says Goldman "no longer wages its own money without client interaction." Whatever that means, it was not a "no," meaning that directly or indirectly Goldman appears to still be making "the bulk of its profit from proprietary [trading] instead of client work."

As we set forth in comment letters submitted to you earlier, two changes to the proposed rule would effectively reduce bank incentives to evade the Volcker Rule prohibitions.² The first is to break the link between trader bonuses and gains from trading, no matter what the time period involved in the trade. The second is to back up the Volcker Rule prohibitions with swift, certain and meaningful penalties for traders, supervisors and executives who violate them. Such provisions would not only be relatively easier to implement, monitor and enforce by regulators and market participants, but it would also reduce the opportunities for evasion and gaming while enacting the rule as required by the law.

In light of the Bloomberg story, which illustrates just one way banks have already maneuvered around parts of the rule as drafted, we urge you to consider strengthening the proposed rule to eliminate their incentives for evasion.

We hope these comments are helpful.

Sincerely,



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² http://www.bettermarkets.com/sites/default/files/SEC-%20CL-%20Volcker%20Rule-%202013-12_1.pdf;

<http://www.bettermarkets.com/sites/default/files/CL%20CFTC%20FINAL%20Volcker%20Rule%204-16-12.pdf>

Secret Goldman Team Sidesteps Volcker After Blankfein Vow

By Max Abelson - Jan 8, 2013

Sitting onstage in Washington's Ronald Reagan Building in July, Lloyd C. Blankfein said Goldman Sachs Group Inc. (GS) had stopped using its own money to make bets on the bank's behalf.

"We shut off that activity," the chief executive officer told more than 400 people at a lunch organized by the Economic Club of Washington, D.C., slicing the air with his hand. The bank no longer had proprietary traders who "just put on risks that they wanted" and didn't interact with clients, he said.

That may come as a surprise to people working in a secretive Goldman Sachs group called Multi-Strategy Investing, or MSI. It wagers about \$1 billion of the New York-based firm's own funds on the stocks and bonds of companies, including a mortgage servicer and a cement producer, according to interviews with more than 20 people who worked for and with the group, some as recently as last year. The unit, headed by two 1999 Princeton University classmates, has no clients, the people said.

The team's survival shows how Goldman Sachs has worked around regulations curbing proprietary bets at banks. Former Federal Reserve Chairman Paul A. Volcker singled out the company in 2009, saying it shouldn't get taxpayer support if it focuses on trading. A section of the 2010 Dodd-Frank Act known as the Volcker rule, drafted to prevent banks from taking on excessive risk, limits short-term investments made with firms' capital.

The law doesn't bar longer-term wagers. That leaves room for other risky investments, according to Matthew Richardson, an economics professor at New York University's Stern School of Business. Bets that last months can go awry and belong outside federally backed banks, he said.

"From a systemic-risk perspective, it's really the longer-term holdings which are of issue," said Richardson, who heads NYU's Salomon Center for the Study of Financial Institutions.

'The Don'

Michael DuVally, a Goldman Sachs spokesman, said in an e-mail that MSI engages in long-term investing and lending. A 2011 proposal for implementing the Volcker rule uses a 60-day cutoff to classify short-term trades.

“We have made changes to the strategies this business historically has employed to bring them into compliance with our current understanding of the Volcker rule,” said DuVally, who declined to make MSI executives available for interviews. “If the final rule requires additional changes, we’ll make them.”

The team of about a dozen people, based at the firm’s Manhattan headquarters, is headed by Daniel Oneglia and Geoff Adamson. Oneglia was treasurer of the Princeton eating club Tiger Inn, where his nicknames included “the Don” and “the Weasel,” according to the university’s website. Adamson was coxswain for men’s heavyweight varsity crew. A Boston Globe photo shows teammates flinging him into a Massachusetts lake after a victory.

Hedge Fund

Their team at Goldman Sachs has bet against companies through short selling, or the sale of borrowed securities, and while investments are supposed to last for months they sometimes end early, according to half a dozen former members.

“MSI is very much like a hedge fund,” said Ashkan Marsh, 30, who worked for the unit before leaving the firm in 2008.

Goldman Sachs, the fifth-biggest U.S. bank by assets, doesn’t report on the holdings or performance of MSI, or of the Special Situations Group in which it’s housed. That parent group, which uses the firm’s funds to profit from distressed and middle-market companies, has been a major profit center at the bank, sometimes the biggest, former executives told Bloomberg in 2011. Its holdings that year included debt of Melville, New York-based pizza chain Sbarro Inc.

Slaughtered Pig

“SSG had its own culture from Goldman, one of those things where everyone had sharp elbows, but in a good way,” said Ryan Frankel, 29, who worked in the division until 2008 and is now CEO of VerbalizeIt Inc., a New York-based translation company. “It was definitely the place to be. I felt very honored and excited and lucky to be there.”

Marsh, now a Harvard Business School student, recalled a trip with colleagues to Texas with paintball, portfolio analysis and freshly slaughtered pork. The team paid “an extreme amount” to a farm that “killed the pig that day and barbecued it for us,” he said. “We would go boating, we’d go golfing, I really felt very much that they were friends.”

Tamin Pechet, 34, who worked in a predecessor group before he left the bank in 2005 and has stayed in touch with former co-workers, said MSI still has similar people and strategies.

"In spite of all of these things which seem like exogenous factors that would mean that a group like this couldn't possibly continue, there's actually quite a bit of continuity," said Pechet, now CEO of Banyan Water Inc., a San Francisco-based commercial water manager.

He recalled a "passion for and understanding of how to make money" among "extraordinarily commercial" colleagues.

'Elegant Animals'

MSI looks for members who are "driven, motivated and excel in everything they have done," James Brower, who was on the team until 2010, said at a [University of Pennsylvania panel](#) on banking and the liberal arts sponsored by Goldman Sachs in 2006.

The team's traders "should be market-savvy, enjoy a quick pace, dislike long-term projects and have a risk appetite," Brower said, according to a transcript. They look across many asset classes, he said, investing "hedge-fund style."

Brower is now an analyst at Serengeti Asset Management LP, a New York-based hedge fund founded by Jody LaNasa, who ran MSI from 2002 to 2006. LaNasa named his firm after the African region because of his admiration for leopards, "elegant animals who hunt by themselves," he said in a 2012 interview with the Harvard Law Bulletin. MSI managed more than \$4 billion when he was in charge, LaNasa said.

Treasury Medal

Other former members refer to the team as a hedge fund. G. David Bednar, now a managing director at Ladder Capital Finance LLC, worked in SSG's "proprietary multi-strategy hedge fund" until 2006, according to his LinkedIn profile. Cevdet Samikoglu was at MSI's predecessor, Special Situations Investing, a "proprietary internal hedge fund," before he left in 2003 and joined Greywolf Capital Management LP, filings show.

Another MSI veteran, David N. Miller, became chief investment officer of the Troubled Asset Relief Program, which rescued U.S. banks during the 2008 financial crisis. He was awarded the Treasury Medal by Secretary [Timothy F. Geithner](#) when he left and is now CEO of a real-estate investment trust.

Miller, LaNasa, Bednar and Brower declined to comment. Samikoglu didn't respond to two phone messages.

Ocwen, Cemex

MSI investments last year included shares of Ocwen Financial Corp. (OCN), a West Palm Beach, Florida-based mortgage servicer, according to two former team members.

Goldman Sachs sold Litton Loan Servicing LP to Ocwen for \$263.7 million in 2011. To gain New York State approval, the firms said they would compensate borrowers whose homes were wrongly foreclosed and make changes to prevent “robo-signing,” where documents are automatically signed without verification.

The bank owned 2.3 million Ocwen shares as of Sept. 30, according to filings that don’t disclose which part of Goldman Sachs holds them. The firm had more than 3 million Ocwen shares before the deal was announced, filings show.

Another MSI proprietary investment was in Monterrey, Mexico-based Cemex SAB (CEMEXCPO), the largest cement maker in the Americas, according to two former members of the Special Situations Group who requested anonymity because they weren’t authorized to speak.

‘Handsome Returns’

MSI doesn’t trade in and out of positions each day, according to alumni, and one said he wished he could have traded more. Still, the team sold most assets after a few months, said Marsh, the former member who’s now at Harvard. Jeanette Cajide, 36, an associate in the Special Situations Group in 2007 and 2008 who now works in development at Dialexa LLC, a Dallas-based technology firm, said she was jealous of MSI’s faster pace.

Goldman Sachs has been wagering its own money for decades. After the firm bought commodities broker J. Aron in 1981, the unit risked the bank’s capital “not in the service of clients but simply to achieve handsome returns,” according to “Goldman Sachs: The Culture of Success” by Lisa Endlich, an ex-employee.

Harvey M. Schwartz, 48, who will succeed Chief Financial Officer David Viniar when he steps down this month and joins the board, began his Goldman Sachs career at J. Aron, as did Blankfein and President Gary D. Cohn.

The firm also used its own capital for risk arbitrage, or betting on takeover targets, under a team led in the 1980s by Robert Rubin, who became Goldman Sachs’s co-chairman and later U.S. Treasury secretary. The group grew into the equities division’s Principal Strategies team. A separate global macro desk speculated on currencies and rates.

Blankfein, Viniar

Blankfein’s comments about shuttered proprietary businesses, and similar remarks a year earlier by

Viniar at a conference in Miami, referred to those two teams, DuVally said in his e-mail. The firm has said in filings that Principal Strategies was closed in 2010 and global macro in 2011.

MSI, which stayed open, started in the late 1990s as Special Situations Investing. It became part of SSG in 2003, when Mark McGoldrick, a former Goldman Sachs partner, combined proprietary units into one global business. He left four years later, disappointed by a \$70 million bonus, the Wall Street Journal reported.

The bank's proprietary stock holdings were so large that markdowns on stakes in Asia helped wipe out revenue from client work there in 2011, according to data compiled by Bloomberg.

Clients First

"It's been shut down," Viniar, 57, said of the firm's proprietary-trading business at the Credit Suisse Financial Services Forum on Feb. 9, 2011. "Whatever effects there have been, you've seen them already."

Nine days later, the Special Situations Group posted a Hong Kong job listing seeking a person skilled in equities, loans and bonds. The job "mainly consists of valuing companies and their associated securities," according to the posting.

Cajide, who left SSG in 2008, called it a "very hush- hush" division because it wagers the firm's capital.

"You don't talk about what you're doing," she said. "It's Goldman's money, right?"

The page on the bank's website that describes businesses inside SSG, including specialty lending and alternative energy, doesn't mention Multi-Strategy Investing.

After the Securities and Exchange Commission accused Goldman Sachs in 2010 of defrauding clients in the sale of collateralized debt obligations and before the company settled for a record \$550 million, the firm created a committee to review its business practices. The group reiterated the company's late-1970s principles that said clients come first.

'More Prop'

To comply with Dodd-Frank, banks from Goldman Sachs to Morgan Stanley and JPMorgan Chase & Co. (JPM) have said they would break off or wind down proprietary units.

"We should not be a firm that is betting our shareholders' capital for our own benefit," Morgan Stanley CEO James Gorman, 54, said at a Securities Industry and Financial Markets Association

conference in November 2010. “We should be working with our shareholders’ capital for our clients’ benefit.”

Even so, with banks pushing in Washington to limit the trading rule, not all proprietary bets were banned. Former Fed Chairman Volcker, who graduated from Princeton 50 years before Oneglia and Adamson, pushed to bar long-term investments when Dodd-Frank was written, according to three people with knowledge of the talks. He tried again when regulators drafted rules based on the legislation, they said.

“There were so many elements of the rule that in order to get it passed had to be softened quite a bit, and that may very well have been one,” Kimberly Krawiec, a law professor at Duke University in Durham, North Carolina, said of the focus on short-term trading. “There’s going to be more prop trading than what the general public and perhaps even some experts believe.”

‘Volcker Firewall’

Regulators, who had planned on completing rule-writing by the end of 2012, now expect to finish early this year, according to Fed Chairman Ben S. Bernanke. Firms have until July 2014 to conform to the trading rules.

“The Volcker firewall in Dodd-Frank set up a clear distinction between lending banks and hedge funds,” said Jeff Merkley, an Oregon Democrat and one of two senators who inserted the trading ban into the legislation. “Any way you slice it, the work of the London Whale and similar setups are hedge funds, whether the trades endure days or months. The regulators have full authority and clear direction to prohibit these operations. They have stalled for two years, and it is way past time for them to act.”

Not Venal

Even before JPMorgan lost about \$6.2 billion on wrong-way bets by a trader who came to be known as the London Whale, the SEC expressed confusion about how much wagering the firm was doing with its own money. The agency wrote to the New York based bank, the largest in the U.S by assets, after the company said in 2011 filings that it no longer had proprietary holdings in its equities unit. It “is not clear if this was the extent of your proprietary-trading business,” the SEC letter said.

At the lunch in Washington where Blankfein spoke, he was asked by private-equity billionaire David Rubenstein, co-CEO of Carlyle Group LP (CG), if Goldman Sachs makes the bulk of its profit from proprietary instead of client work. Blankfein, 58, said the firm no longer wagers its own money without client interaction.

“Our job is to grow the pie and make everybody wealthier,” Blankfein said. “Not for the venality of trying to get richer and more wealthy, but wealth in the sense of making the world stronger and healthier -- and, for lack of a better word, better.”

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